Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:

The Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC)

CC Docket No. 93-50

MCI COMMENTS

MCI Telecommunications Corporation (MCI) hereby comments on the Notice of Proposed Rulemaking in the proceeding below.[1] The Commission tentatively concludes that amendment of its accounting and ratemaking rules related to the Allowance for Funds Used During Construction (AFUDC) is in order.[2]

The Commission's existing rules do not allow the cost of Plant Under Construction - Long Term (PUC-LT) to be included in the rate base.[3] An AFUDC representing the "[r]easonable amounts of interest during the construction period"[4] is added to the amount that will be transferred to Total Plant in Service (TPIS), and thus included in the ratebase, when the project is completed. The Commission's policy is for AFUDC to be computed using the "compound prime

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[1] The Accounting and Ratemaking Treatment for the Allowance for Funds Used During Construction (AFUDC), Notice of Proposed Rulemaking, CC Docket No. 93-50, Released March 22, 1993 (NPRM).

[2] Id. at para. 13.

[3] See, 47 C.F.R. Section 32.2004 and Section 65.820. PUC-LT is defined as long term construction projects designed to be completed in more than one year. 47 C.F.R. Section 32.2004.

[4] 47 C.F.R. Section 32.2000(c)(2)(x)(A).

rate of interest."[5] Plant Under Construction - Short Term (PUC-ST) is included in the current rate base and interest is not capitalized.[6]

The Commission proposes to modify these rules:

> In this notice, we propose changes to our Rules that would require the use of the Revenue Requirement Offset Method for both long-term and short-term construction and that would provide for interest capitalization according to the GAAP requirements, as stated in SFAS 34 and its amendments.[7]

MCI agrees that treating short-term and long-term construction similarly would be beneficial to the public. However, as MCI will demonstrate herein, the Commission's proposal would, contrary to well-established Commission policy, result in charges to current ratepayers for both long-term and short-term construction projects which only benefit future ratepayers. Thus, the proposed change with respect to long-term construction is not in the public interest. MCI, therefore, urges the Commission to adopt the capitalization method for all telecommunications plant under construction (PUC).

Additionally, MCI respectfully requests that the Commission retain the compounded prime rate for capitalized interest, as it provides adequate compensation to investors while encouraging the LECs to complete construction as expeditiously as reasonably possible.

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[5] See, AT&T - Charges for Interstate Services, 64 F.C.C.2d 1 (1977), recon., 67 F.C.C.2d 1429 (1978), and Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, 3 FCC Rcd 269, 273 para. 32 (1987), recon., 4 FCC Rcd 1697, 1703 para. 56.

[6] 47 C.F.R. Section 32.2003 and Section 65.820.

[7] NPRM. at para. 17. [footnote omitted]

I. THE CAPITALIZATION METHOD SHOULD BE USED FOR PUC-ST AS WELL AS PUC-LT

With respect to PUC-LT, the Commission's long established rules appropriately recognize the inequity of requiring current ratepayers to bear the cost of future construction. In Docket No. 19129,[8] the Commission, after careful consideration, concluded that long-term construction projects were not useful to current ratepayers and, therefore, "... investors are not necessarily entitled to receive from the ratepayers the rate of return prescribed for it until the plant is placed into service."[9] The Commission's decision was specifically upheld by the court.[10]

In the NPRM, the Commission discussed three treatments of PUC.[11] Of these, the capitalization method alone insures that only those ratepayers that benefit from the investment will be charged for it. MCI agrees with the

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[8] AT&T - Charges for Interstate Services, 64 F.C.C.2d 1 (1977), recon., 67 F.C.C.2d 1429 (1978). (Docket No. 19129).

[9] Id. at p. 60. The Commission also noted: "We find it unreasonable and clearly not in the public interest for AT&T or this Commission to burden current ratepayers with a project (e.g. construction of a new coaxial cable) that will not be placed into service for 5 to 8 years." Id. at p. 59.

[10] See, Illinois Bell Telephone v. F.C.C. 911 F.2d 776 (D.C. Cir 1990) (Illinois Bell) at p. 781.

[11] The three methods are as follows: 1.) Capitalization Method. Exclude plant under construction from the rate base, but capitalize an allowance for interest on such plant under construction (ie. AFUDC) by including it in the cost of construction. When plant is put into service, the cost of construction, including the capitalized AFUDC, is included in the rate base, and the AFUDC cost is recovered through depreciation. 2.) Rate Base Method. Include plant under construction in the rate base and do not capitalize AFUDC. 3.) Revenue Requirement Offset Method. Include plant under construction in the rate base and recognize AFUDC as part of the cost of construction. Since plant under construction is included in the ratebase, the amount of AFUDC capitalized is included in income for ratemaking purposes, and, thereby, serves to offset the revenue requirement determination for the development of rates for services. NPRM at para. 2.

Commission that PUC-ST and PUC-LT should be treated similarly.[12] However, to be fair to current ratepayers, the Commission should not allow the LECs to charge for any investment until it can be considered "used and useful" for the provision of telecommunications service. To require otherwise would be contrary to the public interest.

Yet, the Commission, inexplicably, proposes use of the Revenue Offset method for both PUC-LT and PUC-ST, which would allow construction of future assets to be included in the current ratebase.[13] The Revenue Offset Method would, in effect, allow a portion of the rate of return for this future investment to be charged to current ratepayers.[14]

Clearly, adopting the Revenue Offset Method for PUC-LT would be a dramatic departure from established law and policy. The only conceivable argument in favor of the Revenue Offset Method would be the desire to assure that investors will be adequately compensated for capital devoted to the construction of telecommunications assets.[15]

However, investors are, in fact, fully compensated through the capitalization method, as they receive the full rate of return on both the investment and the accumulated interest on that investment when the plant is put into service.

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[12] Id. at para. 17.

[13] Id.

[14] The Revenue Offset Method would allow the rate of return less the cost of debt for PUC to be charged to current ratepayers. NPRM at para. 2.

[15] The Commission expresses a desire to "achieve the fairness to investors sought by Ameritech." NPRM at para. 14.

Additionally, evidence suggests that neither Ameritech, nor any other carrier, has experienced difficulty in attracting investors or funding long-term construction projects. To the contrary, the most recent Form M reports submitted by the Regional Bell Operating Companies indicate that PUC-LT exceeds a billion dollars.[16]

Moreover, the Commission must consider the impact of proposed rule changes on the other public policy goals underlying its current rules. In reaching a decision to use the capitalization method (and capitalize interest at the prime rate), the Commission explained these goals:

> ...public interest considerations require that we provide such incentives as are necessary to insure efficient, <u>low-cost</u> communications services....Allowing IDC to accrue at a compounded prime rate provides adequate compensation to investors <u>and encourages AT&T to complete construction as expeditiously as reasonably possible</u>.[17]

The Commission's tentative conclusion would result in a charge to ratepayers, when the plant is put into service, for the full rate of return on both the investment and the accrued compounded interest at a rate that is likely to be higher than the currently used "prime rate." Additionally, ratepayers will be assessed the differential between the current rate of return and the allowed cost of debt.[18] Contrary to the Commission's goal of insuring "low-cost"

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[16] Data accumulated from the RBOC 1991 Form M Reports, Schedule B1.

[17] Docket No. 19129 at 60. [emphasis added]

[18] For price cap carriers, the impact to ratepayers would occur either through exogenous treatment of the change or, at a minimum, through the amount of earnings available for sharing.

communications service, the Revenue Offset Method would clearly increase the costs to ratepayers for PUC-LT.

Moreover, with the Revenue Offset Method for PUC-LT, carriers will not be incented to complete construction quickly, as they will be overcompensated for the lag in completion. Thus, the proposed rule will encourage languishing construction projects and increased expense to ratepayers, many of whom may never even receive the benefits of the investment. Thus, MCI respectfully requests that the Commission adopt rules specifying that the capitalization method alone be used for both PUC-LT and PUC-ST.

II. USE OF THE PRIME RATE FOR CAPITALIZING INTEREST WOULD BEST SERVE THE PUBLIC INTEREST

The Commission's rules currently provide for the recovery of "reasonable amounts of interest during the construction period" for PUC-LT.[19] The [illegible] deployment of low-cost telecommunications plant far outweighs any administrative burdens involved with separate recordkeeping.

When the Commission decided to prohibit including long-term construction in the ratebase in Docket 19129, the question arose as to how the investors would receive reasonable compensation for their investments. The Commission found that AT&T had the ability to obtain short-term funding at the prime rate, and it recognized that the most reasonable and equitable solution would be to require interest during construction (IDC) to be computed and compounded using that same rate.

The Commission stated:

> The Bell System is presently charged the prime rate by financial institutions for its short-term debt and promissory notes. Such short-term funding presently constitutes a very minor portion of its total capital obligations (less than 3%) but a significant portion of its construction budget (more than 23%). We are confident AT&T could, if it so desired, fund an even greater share of its construction program with short-term debt (at prime rate) with no adverse consequences to its overall financial stability or cost of capital. Consequently, we find that it is unreasonable to burden future ratepayers with interest charges associated with Plant Under Construction that exceed the prime rate.[21]

In short, the Commission was confident that the use of short-term funding, coupled with proper management of construction projects to assure their timely placement in service, enured to the benefit of the ratepayer and the investor.

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[21] Docket No. 19129 at p. 56.

The Commission has repeatedly required "reasonable interest" as the appropriate benchmark rather than some possibly more expensive LEC determination of the appropriate funding.[22] Retaining the short-term interest rate (prime interest rate) for PUC-LT will further the Commission's goal of encouraging timely completion of construction projects and will appropriately compensate the LECs for the investment in long-term construction projects. Thus, MCI urges the Commission to require the use of the prime rate to capitalize interest on both PUC-LT and PUC-ST.

[22] The court, in Communications Satellite Corp. v. FCC, 611 F. 2d 883, 895-97 (D.C. Cir. 1977) (Comsat), found that the actual funding sources that Comsat used were irrelevant. In fact the Commission had the prerogative to impute a reasonable capital structure. 56 FCC 2d 1160 (1975).

III. CONCLUSION

The Commission's rationale, expressed in Docket 19129, for using the capitalization method and capitalizing interest at the prime rate with respect to PUC-LT is still valid. However, to assure that ratepayers do not pay for any investment until it is actually placed in service, and to make accounting more simple, MCI respectfully requests that the Commission apply rules for PUC-ST that are consistent with the rules currently used for PUC-LT. Specifically, for the reasons discussed herein, MCI urges the Commission to use the capitalization method, capitalizing interest at the prime rate, for both PUC-LT and PUC-ST.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Susan Travis, do hereby certify that copies of the foregoing MCI Petition were sent via first class mail, postage paid, to the following on this 13th day of May 1993:

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